



Semiannual Report to Congress

October 1, 2001 – March 31, 2002

OIG

Office of Inspector General



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

OFFICE OF INSPECTOR GENERAL

April 30, 2002

The Honorable Alan Greenspan
Chairman
Board of Governors of the Federal Reserve System
Washington, DC 20551

Dear Chairman Greenspan:

I am pleased to present our *Semiannual Report to Congress* for the reporting period October 1, 2001, through March 31, 2002. This report, summarizing the activities of the Office of Inspector General of the Board of Governors of the Federal Reserve System, is presented according to our strategic goals and objectives. As reflected in the report, we performed a variety of audits, reviews, investigations, and special projects that encompassed a wide range of the Board's programs and operations.

The Inspector General Act requires that you transmit this report to the appropriate congressional committees within thirty days of receipt, together with a separate management report and any comments you wish to make.

Sincerely,

A handwritten signature in black ink, reading "Barry R. Snyder", is positioned below the word "Sincerely,".

Barry R. Snyder
Inspector General

Enclosure



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Table of Contents

	Page
Introduction.....	1
Goal 1: Provide Value-Added Customer Service to the Board.....	3
Goal 2: Enhance Coordination and Information Sharing.....	16
Goal 3: Enhance Internal Operations	20
Appendixes.....	23
Appendix 1—Audit Reports Issued with Questioned Costs for the Period October 1, 2001, through March 31, 2002.....	25
Appendix 2—Audit Reports Issued with Recommendations That Funds Be Put to Better Use for the Period October 1, 2001, through March 31, 2002	26
Appendix 3—OIG Audit Reports and Recommendations	27
Appendix 4—Cross-References to the Inspector General Act.....	28

Introduction

The mission of the Office of Inspector General (OIG), as prescribed by the Inspector General Act of 1978 (as amended), requires that we

- conduct and supervise independent and objective audits, investigations, and other reviews of the programs and operations of the Board of Governors of the Federal Reserve System (Board);
- promote economy, efficiency, and effectiveness within the Board;
- help prevent and detect fraud, waste, and mismanagement in the Board's programs and operations;
- review existing and proposed legislation and regulations and make recommendations regarding possible improvements relating to Board programs and operations; and
- keep the Chairman and Congress fully and currently informed of problems.

Additionally, the Federal Deposit Insurance Act (as amended) requires us to review failed financial institutions supervised by the Board that result in a material loss to the bank insurance fund, and to produce, within six months of the loss, a report that includes suggestions for improving the Board's banking supervision practices. Further, through an agreement with other financial institutions regulatory agency Inspectors General charged with the same legislative requirement, we will address any relationship of Board-regulated holding companies to material losses to the fund from failed financial institutions supervised by any of these agencies.

The OIG currently performs its duties and responsibilities under three major program areas (as shown in the organizational chart that follows). Combined, these program areas perform traditional audits and investigations as well as some nontraditional consulting and partnering with Board management and staff.

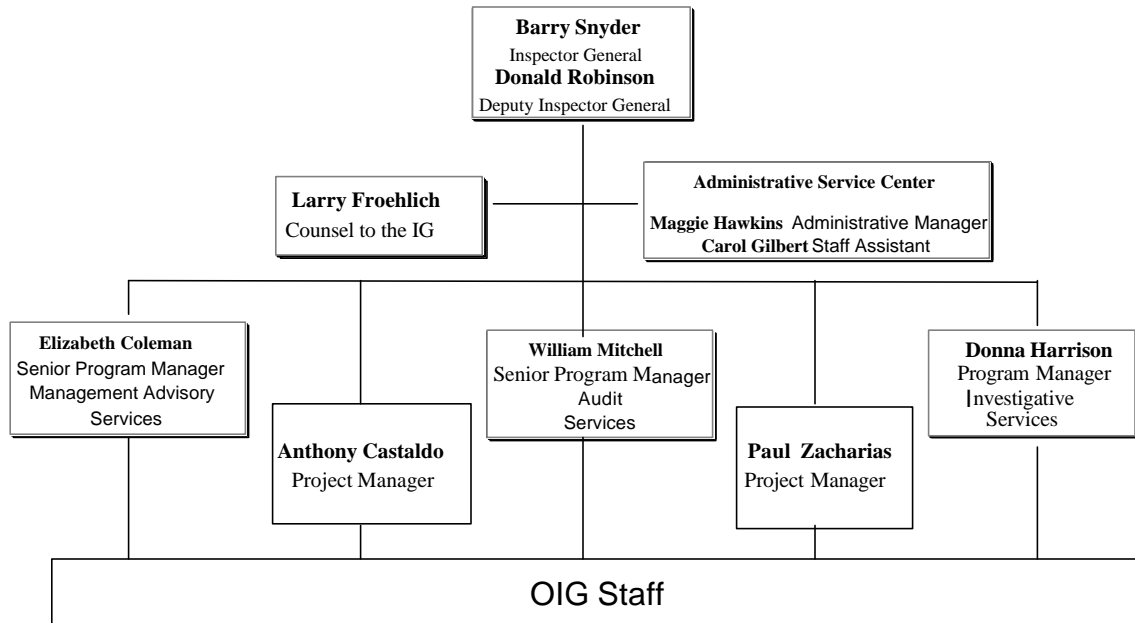
Our strategic plan for the period 2000 through 2004 includes the following three goals that guide our work:

- to provide value-added customer service to the Board;
- to enhance coordination and information sharing with the Congress, the IG community, and others; and
- to enhance the efficiency and effectiveness of our internal operations.

We are submitting our accomplishments and work in progress as they relate to these strategic goals and related objectives. Our statistical tables, as prescribed by the Inspector General Act, are shown in appendixes 1 through 4.

Office of Inspector General

January 2002



OIG Staffing	
Auditors.....	17
EDP Auditors.....	3
Investigators.....	4
Attorney.....	1
Administrative	2
Information Systems Analysts	2
Total Positions	29

Goal 1: Provide Value-Added Customer Service to the Board

Our first strategic goal focuses on providing value-added customer service to the Board. Our work within this goal focuses on the four strategic objectives that follow:

Improve and Enhance the Board's Program Operations

Over the next five years, the Board will continue to operate in a dynamic environment, shaped by legislative reform, increased emphasis on results and performance management, and innovations in the banking industry that require corresponding changes in the Board's supervision and regulation programs, as well as its Federal Reserve System (System) oversight functions. Within this environment, we are focusing on improving and enhancing Board programs and operations. Our work under this objective for this reporting period follows:

Review of the Federal Reserve's Supervision of Hamilton Bancorp, Inc.

We are in the process of reviewing the Board's supervision of Hamilton Bancorp, Inc. (Bancorp), a noncomplex bank holding company, that conducted operations through its wholly-owned bank subsidiary, Hamilton Bank, N.A. (Hamilton) and a nonbank subsidiary. On January 11, 2002, the Office of the Comptroller of the Currency (OCC) closed Hamilton, and the Federal Deposit Insurance Corporation (FDIC) was appointed as Receiver. The failure of Hamilton will almost certainly result in a material loss to the FDIC's Bank Insurance Fund (BIF) as defined by section 38(k) of the amended Federal Deposit Insurance Act (FDI Act). Since the OCC was Hamilton's primary regulator, the FDI Act requires that the Department of Treasury's (Treasury) OIG review OCC's supervision of Hamilton to (1) ascertain why the institution's problems resulted in a material loss to the insurance fund; and (2) make recommendations for preventing any such loss in the future.

The FDI Act does not mandate a review of the holding company of a failed depository institution. Nevertheless, the Inspectors General of the Board, Treasury, and FDIC entered into a Memorandum of Understanding, in August 1994, which states that the Board's OIG will perform a separate review of holding company supervision under the general audit authority of the Inspector General Act. Accordingly, we are in the process of reviewing the holding company supervision, as well as actions taken by the holding company and its nonbank subsidiary to determine if they contributed to the failure of Hamilton and the anticipated material loss to the BIF. We are coordinating our efforts with staff from the Treasury's OIG, who are conducting the Hamilton material loss review.

Interagency Review of the Federal Financial Institutions Examination Council

In 1998, representatives from the OIGs of the Board, Treasury, FDIC, and the National Credit Union Association performed an audit scoping review of the operations of the Federal Financial Institutions Examination Council (FFIEC). The review identified several areas for potential audit follow-up. The following year, representatives from these same offices conducted a joint review of the FFIEC's training program. During this period, the OIGs began a joint review focusing on the FFIEC's overall mission. Specifically, this review is designed to determine whether the FFIEC is meeting its mission of prescribing uniform principles and standards for the examination of financial institutions. The review will also assess the FFIEC's role as a result of the Gramm-Leach-Bliley Act to determine whether the FFIEC should be expanded to include representatives from the Securities and Exchange Commission and insurance industry regulators. Fieldwork has nearly been completed and a report is being developed. We will summarize the results of this review in our next semiannual report.

Follow-up of the Consumer Compliance Examination Process

During the reporting period, we continued follow-up work related to our April 1995 *Audit of the Board's Consumer Compliance Examination Process*. Our audit report contained fourteen recommendations designed to improve the efficiency and effectiveness of the consumer compliance examination process. During previous follow-ups, we determined that management had taken sufficient actions to close twelve recommendations. The two remaining recommendations addressed improving the quality controls over the examination process and the development of "best practices." Based on this follow-up, we believe that sufficient action has been taken to close the remaining recommendations.

Follow-up of the Federal Reserve's Implementation of the Community Reinvestment Act

We completed a second follow-up related to our March 1999 *Report on the Audit of the Federal Reserve's Implementation of the Community Reinvestment Act*. Our audit report contained eight recommendations designed to improve the efficiency, effectiveness, and consistency of the Community Reinvestment Act (CRA) supervisory process. Our initial follow-up, performed in 2000, resulted in closing five of the eight report recommendations; actions pertaining to the remaining three recommendations were in process at that time. Based on our current follow-up work, we determined that sufficient action has been taken to close these recommendations. Specifically:

- To enhance the quality of reported data, the FFIEC issued *A Guide to CRA Data Collection and Reporting* in January 2001 and the FFIEC member

agencies also updated the *Interagency Questions and Answers Regarding CRA* in July 2001, adding that document to the FFIEC web site.

- To help ensure data quality, the Division of Consumer and Community Affairs issued a policy letter to officers and managers in charge of consumer affairs sections that announced a uniform policy for sampling and resubmission of CRA data collected and maintained by state member banks (CA 01-8, August 16, 2001).
- In July 2001, the Federal Reserve and the other banking regulatory agencies issued a joint, advanced notice of proposed rulemaking that sought public comment and suggestions on ways to improve CRA regulations.

Strengthen and Streamline the Board's Operational Infrastructure

Over the next few years the Board faces certain challenges in ensuring that it has the people, processes, and technology that it will need to meet the evolving and varying needs of its clients and to provide a wide range of high-quality services in a cost-effective manner. To be effective, the Board will need to reexamine its financial management, human capital, administrative operations, and communications infrastructure with a view toward improving operations and strengthening accountability. We will provide value-added services to help Board management ensure that it has the integrated internal systems, policies, and processes it needs to meet these new demands. Our work under this objective during this reporting period follows:

Finance Function Assessment

During the period, we issued our *Report on the Finance Function Assessment* and provided a detailed briefing to the Staff Director for Management, the Director of the Management Division, the Associate Director for Finance, and Finance Function managers. The objective of this engagement was to conduct a comprehensive review of Finance Function operations and to identify opportunities for improving core business processes. To accomplish this objective, we conducted over twenty facilitated sessions with key managers and staff in the Management Division. Based on data gathered during these sessions as well as follow-up meetings, we developed detailed business process maps that provided a comprehensive graphical depiction of work flow, cross-functional interaction, internal control points, manual work steps, use of automated systems, and data inputs and outputs.

Our approach to this assessment was designed to recognize the interdependent nature of finance activities and encompassed the following key cross-functional finance processes:

- Purchase to Payment? activities ranging from initiating a purchase requisition to disbursing supplier payments.
- Order to Cash? activities ranging from customer invoicing to receivables management and collections.
- Payroll? activities ranging from data gathering and entry to payroll processing and distribution of pay advices.
- Close, Consolidation, and Reporting? activities ranging from managing the general ledger to financial and operational reporting.
- Budgeting and Planning? activities ranging from strategic planning to budget development and execution.

We assessed each of these processes using a benchmarking model that was developed jointly with consultants. The model was tailored to fit an organization the size of the Board and featured a continuum of finance best practices ranging from "basic" to "leading edge."

Overall, we observed that each of the key Finance Function processes fulfills its basic business objective and the internal control framework appears to be adequate. Using our benchmarking methodology, we identified gaps between the Board's current status and best practices, and developed twenty-four opportunities for improvement that revolve around four major themes? economy and efficiency of operations, use of technology, risk management, and strategic and operational planning. The officers and managers within the Management Division generally agreed with our assessment, and we will provide any additional information necessary to facilitate implementation efforts.

OIG Facilitation of Strategic Planning for Security Enhancements

In response to the events of September 11, 2001, the Board has focused heightened attention on security risks. The Board engaged various security consultants who recommended a variety of infrastructure enhancements, the most important of which were implemented on an expedited basis. To ensure that ongoing and future decisions on security-related projects are made in a strategic context, the Staff Director for Management initiated a comprehensive security planning effort that involved senior Board officers and managers. The OIG was asked to facilitate two planning sessions and assist in security plan development efforts.

The Staff Director established three objectives to be achieved during the facilitated sessions

- establish consensus on a prioritized list of security-related issues to be addressed over the forthcoming year;
- prepare a schematic overview laying out the critical path, milestones, and interrelationships among each project; and
- assign responsibility for each specific task.

A wide range of security-related topics were addressed during the facilitated sessions including requirements for the Board's security force, physical security enhancements, continuity of operations planning, and critical infrastructure protection. The resultant security plan is being completed and key components will be presented to the Board's Committee on Board Affairs in the near future.

Phase II of the Business Process Review of the Board's Publications Program

On this second phase of the business process review (BPR), we coordinated with the Publications Committee (committee) to transition the Board's publications program from a document-based to an information-based communications approach that more fully optimizes the advantages of the Internet and electronic media. The publications program supports the Board's missions by making information about the Federal Reserve accessible to the federal government, regulated entities, legal and business communities, libraries and research entities, economists and other scholars, consumers, and the public at large. The committee, composed of senior officials from several Board divisions and offices, oversees the program. As a result of our phase one work, the committee adopted a five-step approach designed to help the Board streamline processing, promote efficient operations, improve performance, implement best practices, and optimize the use of technology in its publications program.

During this period, we completed an analysis of the Board's *Annual Report* and *Annual Report: Budget Review* and briefed the committee chair regarding options for modifying these publications in recognition of information that is or could be available on the Board's public web site. We concluded that (1) the committee has an opportunity to reconsider the purpose, content, and format of the *Annual Report* in light of information on the public web site and the Board's intent to implement performance reporting consistent with the intent of the Government Performance Results Act; and (2) an enhanced presentation of Board and Reserve Bank budget information on the Board's public web site could eliminate the primary reason for publishing the *Annual Report: Budget Review*. The committee chair generally agreed with our conclusions and developed an action plan for pursuing the issues with the full committee.

Audit of the Board's Financial Statements for the Year Ended December 31, 2001, and Audit of the Federal Financial Institutions Examination Council's Financial Statements for the Year Ended December 31, 2001

Each year, we contract for an independent public accounting firm to audit the financial statements of the Board and the FFIEC (the Board performs the accounting function for the FFIEC). Our current contracted auditors, KPMG LLP, planned and performed this year's audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The audits included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The audits also included an assessment of the accounting principles used and significant estimates made by management, as well as an evaluation of overall financial statement presentation. In the auditors' opinion, the Board's and FFIEC's financial statements present fairly, in all material respects, the financial position of each as of December 31, 2001; and the results of operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

To determine the auditing procedures needed to express an opinion on the financial statements, the auditors considered the Board's and the FFIEC's internal controls over financial reporting. Although the auditors' consideration of the internal controls would not necessarily disclose all matters that might be material weaknesses, they noted no such matters. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, the auditors also performed tests of the Board's and the FFIEC's compliance with certain provisions of laws, regulations, contracts, and grants, since noncompliance with these provisions could have a direct and material effect on the determination of the financial statement amounts. The results of the auditors' tests disclosed no instances of noncompliance required to be reported under *Government Auditing Standards*.

Participation on the Audit of the Office of Employee Benefits

We participated with the Reserve Bank General Auditors in an audit of the Office of Employee Benefits. The audit, led by audit staff from the Federal Reserve Bank of New York, included a recalculation of pension payments for a sample of retired employees and a verification of information for active employees. The limited work we performed in support of the audit identified several discrepancies in the information maintained by the contracted retirement plan administrator. We shared this information with Board management and, later this year, we plan to conduct a more in-depth look at administration of the retirement plan for Board employees with the objective of evaluating the controls over plan administration and the maintenance of employee information.

Promote the Board's Effective Use of Technology

Information technology continues to advance at a rapid pace, requiring the Board to continually balance automation requirements and costs with service delivery, efficiency, and security concerns. While Board divisions and offices have made significant progress in integrating information technology into their work, a more fully integrated information technology infrastructure would provide enhanced support to the Board in achieving its mission-related, strategic planning, human capital, and business process objectives. Our work under this objective for this reporting period follows:

Audit of the Board's Secure Communications Program

Last year, we began an audit of the Board's secure voice, facsimile, and video-conferencing communications program. We began the audit as an update to work performed in this area in 1992 and as part of a broader body of work related to the Board's security planning efforts. The objective of the audit was to assess security controls over voice, facsimile, and video-conferencing communications used to process classified and sensitive information. Specifically, we planned to identify the types of information contained in sensitive and classified communications; evaluate the infrastructure, management processes, and controls over these communications; identify potential vulnerabilities and recommend corrective action; and identify opportunities to improve the program's efficiency and effectiveness.

During our audit scoping, we found that there are several ongoing System and Board initiatives related to voice, facsimile, and video-conferencing communications. These initiatives include new audio and video conferencing systems, as well as encrypted data and e-mail applications that offer the potential to reduce the use of secure fax communications. We also found that responsibility for the Board's communication services, including some portions of secure communications, was recently transferred from the former Division of Support Services to the Division of Information Technology (IT).

Because of the ongoing Board and System efforts in this area, and because IT only recently assumed responsibility for the Board's communication services, we have deferred our audit activities in secure communications and are not making formal recommendations at this time. We did, however, provide several suggestions for management to consider as they continue to address the Board's communication requirements and we plan to review the status of these items as part of future audit activities.

BOND Life Cycle Assessment

In support of the Federal Reserve's framework for risk-focused supervision of large complex institutions and foreign banking organizations, the Board's Division of Banking and Supervision (BS&R) and IT developed the Banking Organization National Desktop (BOND). BOND is intended to facilitate the secure information sharing and collaboration necessary for supervision of individual large complex banking organizations, as well as the comparative analysis of institutions with similar business lines and risk characteristics.

In response to a request from BS&R, the OIG is providing an audit-related, third-party perspective on the system development life cycle (SDLC) activities related to BOND. We have established an ongoing liaison with the BOND project management team to provide independent observations and consultative input on SDLC best practices, provide a proactive OIG presence, and offer periodic advisories or observations. Our objective is to help ensure that the BOND application is being implemented in an efficient and effective manner, with proper attention to the control framework.

During this reporting period, we gained an understanding of BOND and reviewed the system development enhancement efforts for the Central Document and Text Repository (CDTR) database that supports BOND. We met with BS&R and IT project management, reviewed background materials, and attended a variety of BOND and CDTR meetings and briefings. Going forward, we will provide BS&R project management with a status briefing on our observations on emerging issues and risks for the scheduled CDTR enhancements and suggestions for preparing for the next phase of the BOND development effort, which will focus on implementing web-enabled, access capabilities.

Follow-up of the Review of Critical Infrastructure Protection (Phase I)

We completed a follow-up of our September 2000 *Report on the Board's Implementation of Critical Infrastructure Protection*. This report concluded the first phase of our office's review of the Board's implementation of the *Clinton Administration's Policy on Critical Infrastructure Protection: Presidential Decision Directive 63* (PDD 63). We conducted this review as part of a multiphased, governmentwide audit effort organized by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency. Our report contained three recommendations pertaining to the Board's planning and assessment activities for protecting critical, cyber-based infrastructures. The three recommendations were directed at improving management of planning and assessment activities at the Board, ensuring effective Board oversight of Reserve Bank infrastructure protection activities, and ensuring that the Board has provided appropriate guidance to regulated financial institutions in light of PDD 63. We

have determined that the Board has taken sufficient actions to close these recommendations.

Follow-up of the Division of Banking Supervision and Regulation Distributed Processing Environment Audit

We completed the second follow-up of our June 1997 *Report on the Audit of the Division of Banking Supervision and Regulation's Distributed Processing Environment*. Our audit report contained five recommendations designed to help enhance the division's management and administration of its distributed processing environment and improve its network security. Our initial follow-up, performed in 1998, determined that sufficient actions had been taken by management to close two of the five recommendations. During the second follow-up, we found that BS&R had transferred many network and server management responsibilities to IT, refined its information systems policies and procedures, and improved its help desk function. These actions adequately addressed the three remaining audit recommendations

Help the Board Limit Risk and Ensure Compliance

The Board operates under a myriad of laws and regulations that have an impact on many aspects of its programs and operations. For example, numerous tax and employment laws and regulations affect the Board's recruiting, compensation, and benefits programs. In addition, Board programs and operations may also be subject to potential damage or loss through fraud, waste, abuse, mismanagement, and employee misconduct. Our work under this object for this reporting period follows:

Audit of the Federal Reserve's Background Investigation Process

We performed this audit pursuant to a request from the U. S. House of Representatives Committee on Financial Services, Subcommittee on Oversight and Investigations (Subcommittee). The Subcommittee was concerned that sensitive and private financial data utilized by federal financial regulatory agencies could be improperly accessed, used, or manipulated. Our audit objective, based on the Subcommittee's request, was to evaluate the policies, procedures, and practices under which the Board conducts, adjudicates, and documents background investigations of prospective and current employees and contractor personnel. Because Reserve Bank personnel participating in the Board's delegated supervision and regulation program also have access to financial data, we included them in the scope of our audit.

Overall, we found that the Board's policies for conducting background investigations of employees and contractors need to be strengthened. The Board's policies governing the employee security program were outdated and had not been communicated to all staff with responsibilities for processing security clearances. We also found that there were no policies documenting the Board's security requirements for contractors or contractor employees, and that summer interns and temporary employees were not required to undergo a background investigation, even though these individuals may potentially have access to sensitive information. We found the Reserve Banks' internal procedures for reviewing the backgrounds of supervision and regulation personnel to be generally effective.

Our report contains three recommendations designed to improve the Board's background investigation process. Specifically, we recommended that the Staff Director for Management update and clarify the current policies for employee background investigations, develop guidance for conducting and documenting background investigations for contractors, and develop policies and procedures for conducting background investigations for summer interns, temporary employees, and transferred employees. We provided a copy of this report to the Staff Director for Management for review and comment. His response concurred with our recommendations and indicated that a Board officer has been assigned responsibility to oversee implementation of the recommendations.

Audit of the Federal Reserve Board's Government Travel Card Program

We completed our audit of the Board's Government Travel Card (GTC) program. Our audit objectives were to evaluate the goals and objectives of the GTC program and determine whether they are being achieved in an efficient and effective manner; assess whether control procedures over authorizing, issuing, controlling, and returning cards are sufficient; determine whether control procedures are adequate to ensure proper use of the cards in accordance with Board policy and procedures; and evaluate program compliance with applicable laws and regulations.

Overall, we found that the internal control framework over the Board's GTC program needs to be strengthened. Although the Board is generally meeting the goals and objectives established when the program was implemented, the current policy and guidance is insufficient to ensure that employees understand the program's requirements or to promote consistent Boardwide implementation. Our review of a sample of GTC accounts showed that the initial dollar limits for charges and cash advances far exceeded the needs of most employees. We also found that the process for reviewing GTC transactions and processing potential violations of the Board's travel regulations is not based on specific criteria, documented properly, or applied consistently. In addition, we found that GTC accounts are not promptly closed when an employee leaves the Board and that

internal operating procedures are not adequately documented. While we did not find any indication that the program was out of compliance with any applicable laws, we did find several potential violations of the Board's travel regulations that we provided to management for their review.

Our audit report contains five recommendations designed to help the Board establish and communicate clear program guidance and to improve internal controls over issuing, monitoring, and canceling government travel cards. The Staff Director for Management generally agreed with our recommendations and we will review corrective actions taken next year.

Audit of the Board's Use of and Controls over Purchase Cards

Last September, we began an audit of the use of and controls over purchase cards. Our overall audit objective was to assess the adequacy of the existing internal controls over the Board's purchase card program. Specifically, we reviewed the adequacy of procedures for issuing cards and ensuring proper use, evaluated cardholders' compliance with current Board policy, and evaluated the program's goals and objectives. We have completed our fieldwork and are finalizing a draft report to provide management for review and comment. We will summarize our audit findings, conclusions, and recommendations in the next semiannual report.

Audit of Contracted Expenditures to Enhance Security in Response to the Events of September 11, 2001

In the fourth quarter of 2001, the Board initiated numerous procurement actions to enhance security in the Eccles, Martin, and New York Avenue buildings. Because of the need to respond quickly to potential terrorist threats and anthrax contamination problems, most of these procurements were undertaken as directed procurements; an approach that is permitted when formal competitive bidding and negotiation processing will not meet the Board's needs. Our audit objectives were to (1) determine if the Board complied with its acquisition policies and used the directed procurement approach appropriately, (2) determine if changes are needed in the Board's policies or procedures for authorizing and conducting directed procurements, and (3) assess whether the Board should apply competitive bidding procedures to any of the ongoing contracts now that the initial emergency period has passed.

During this period, we completed a substantial portion of the fieldwork on this project. We anticipate completion of this project in May 2002 and will summarize our findings and conclusions in the next semiannual report.

Follow-up of the Review of the Board's Frequent Flyer Policy

We completed a follow-up of our *Report on the Review of the Board's Frequent Flyer Policy*. The report contained two recommendations designed to provide a cost-effective control framework that promoted compliance with policies and procedures and encouraged employee participation in a travel incentive program which would provide an economic benefit to the Board and Board staff. Since we issued our report, Congress passed new legislation with respect to the use of frequent flyer miles in the federal government. Specifically, the National Defense Authorization Act for FY 2002 included a provision that allows federal employees to retain for personal use any promotional items, including frequent flyer miles, received as a result of official government travel. We determined that sufficient actions have been taken, in conjunction with the new legislation, to close both of the recommendations.

Investigative Activity

During the reporting period, we opened seven formal investigations and continued work on twenty-five cases that were opened during previous reporting periods. Of the thirty-two active cases, we closed twelve cases, including eleven that were opened from the previous reporting periods. Six of the eleven cases closed involved alleged frequent flyer abuse by Board employees. These cases were referred to the local prosecutor during previous reporting periods to determine whether they merited criminal prosecution. The U.S. Attorney's Office declined prosecution in favor of administrative action for all six of these investigations. The action taken by the Board in these six cases during this reporting period resulted in three suspensions and six written reprimands. The Board has also updated its travel policy to provide more guidance regarding the accumulation and use of frequent flyer awards. Of the remaining five closed cases, three were closed because management deemed no action was necessary, and two were closed due to lack of evidence.

We also closed one case involving an alleged workplace assault that was opened during this reporting period. The U.S. Attorney's Office declined prosecution in this matter, and the Board also declined to take administrative action.

The investigative findings in ten of our active cases involve alleged frequent flyer abuse by former Board employees. Final decisions and administrative action in these ten cases, previously referred to the Board during earlier reporting periods, is pending. At the end of this reporting period, we had twenty active cases. Our summary statistics on investigations are provided in the table that follows:

Summary Statistics on Investigations for the Period of October 1, 2001, through March 31, 2002

Investigative Actions	Number
Investigative Caseload	
Investigations Opened during Reporting Period	7
Investigations Open from Previous Period	25
Investigations Closed during Reporting Period	12
Total Investigations Active at End of Reporting Period	20
Investigative Results for this Period	
Referred to Prosecutor	1
Referred for Audit	0
Referred for Administrative Action	3
Oral and/or Written Reprimand	6
Terminations of Employment	0
Demotion	0
Suspensions	3
Debarments	0
Indictments	0
Convictions	0
Monetary Recoveries	\$0
Civil Actions (Fines and Restitution)	\$0
Criminal Fines: Fines & Restitution	\$0

Goal 2: Enhance Coordination and Information Sharing with the Congress, IG Community and Others

To achieve our mission, we need to work closely with Board management, the General Auditors at the Reserve Banks, the Congress, the IG community, and other stakeholders. We have also continued our coordination with Inspectors General at the financial regulatory agencies to promote consistency in evaluations and priorities and with the IG community across the federal government to provide more global assessments of issues. We also strive to take full advantage of technology and innovative reporting and communications vehicles to enhance information sharing with our diverse stakeholders.

Develop and Enhance Relations with the Congress

By law, the OIG has a duty and responsibility to keep Congress fully and currently informed by means of semiannual and other reports concerning fraud and other serious problems, abuses, and deficiencies relating to the administration of programs and operations administered or financed by the Board, recommend corrective actions concerning such problems, abuses, and deficiencies, and report on the progress made in implementing corrective actions. With the U. S. General Accounting Office increasing its attention on the many broad and more global issues facing the government, we believe we will have a greater responsibility to identify and address current and emerging issues related to Board programs and operations that are of high importance to Congress. Our work under this objective for this reporting period follows:

Review of Legislation and Regulations

One way we fulfill our mission is to review existing and proposed legislative and regulatory items both as part of our routine activities and on an *ad hoc* basis. We routinely keep track of proposed and pending legislation and regulations by researching relevant documents and databases, reviewing lists prepared by the Board's law library, sharing information with others in the IG community, and coordinating with Board programs that also review new and proposed legislation. We then independently analyze the effect that the new or proposed legislation or regulation may have on the efficiency and effectiveness of Board programs and operations. We also review and comment on revisions or additions to the Board's management policy statements and internal administrative procedures.

During this period, we made a number of contributions in the regulatory, legislative, and management policy areas. For example, we commented upon and have worked closely with the Board in developing proposed uniform regulations for Federal Reserve law enforcement authorities to implement section 364 of the USA PATRIOT Act. This section was enacted in the wake of the September 11

attacks, and permits the Board to delegate certain law enforcement authorities to Board personnel for the purpose of protecting the personnel, facilities, and operations of the Federal Reserve System. We also reviewed recent legislation that allows federal employees to retain and use frequent flyer miles accumulated through official travel and worked with Board management to help them develop an appropriate transition to reflect the new legal framework. In response to a governmentwide data call from the Department of Justice, we provided information regarding the scope and implementation of subpoena authority granted to us through the Inspector General Act. Lastly, we analyzed and provided comments on the Board's draft policy statements on topics such as leave and transportation subsidies. Our comments were well received by Board management and incorporated into the policies as appropriate.

Improve Our Responsiveness to All Allegations of Fraud, Waste, Abuse, or Mismanagement and to the Public Requests for Information

We are continuing to look for opportunities to improve our timeliness to Board management and staff, Congressional staff, and others concerning allegations of wrongdoing and to enhance our communications with the general public regarding their potential concerns with the Board's programs and operations and their need for information. Our work under this objective during this reporting period follows:

Hotline Operations

We continued to address allegations of wrongdoing related to the Board's programs and operations, as well as violations of the Board's standards of conduct. During this reporting period, we received 112 complaints, of which 103 were from our hotline operation. Most hotline callers were consumers with complaints or questions about practices of private financial institutions. Those inquiries involved matters such as funds availability, account fees and charges, and accuracy and availability of account records. We continued to receive numerous questions concerning how to process Treasury securities and savings bonds. Other callers contacted us seeking advice about programs and operations of the Board, Federal Reserve Banks, other OIGs, and other financial regulatory agencies. We directed those inquiries to the appropriate Board offices, Banks, or federal or state agencies; we closed all but two of the 103 hotline complaints after our initial analysis and contact with the complainants.

In addition to the hotline complaints, we received nine allegations that were referred to the OIG from Board program staff and other sources. As a result of those allegations, we opened five investigations. In addition, we are continuing our review of fictitious instrument fraud complaints. Fictitious instrument fraud

schemes are those in which promoters promise very high profits based on fictitious instruments they claim are issued, endorsed, or authorized by the System or a well-known financial institution. Our summary statistics of the hotline results are provided in the table that follows:

Summary Statistics on Hotline Results for the Period of October 1, 2001, through March 31, 2002

Investigative Actions	Number
Complaints Referred for Investigation	
Hotline Referrals	103
Audit Referrals	0
Referrals from Other Board Offices	8
Referrals from Other Sources	1
Proactive Efforts by OIG	
Investigations Developed by OIG	0
Results of all Complaints Referred and Proactive Efforts	
Resolved	105
Pending	7
Total Received during Reporting Period	112

Take a Positive Leadership Role in the IG Community

While our primary mission is to enhance Board programs and operations, we are also members of the broader IG community. Executive Order 12805 established the President's Council on Integrity and Efficiency (PCIE) and the Executive Council on Integrity and Efficiency (ECIE). The PCIE is primarily composed of Presidentially appointed IGs, while the ECIE is composed of statutory IGs of designated federal entities. The order directs the councils to continually identify, review, and discuss areas of weakness and vulnerability to fraud, waste, and abuse, in federal programs and operations, and to develop plans for coordinated, governmentwide activities that address these problems and promote economy and efficiency. In addition, the community strives to address a number of common environmental factors, such as auditor and investigator training, OIG operations, management issues, and legislative changes. Our work under this objective during this period follows:

Peer Review of the Tennessee Valley Authority Office of Inspector General

During this period, we were requested to conduct an external quality control review of the audit operations of the Office of Inspector General for the

Tennessee Valley Authority. We conducted the review in conformity with standards and guidelines established by the PCIE and the General Accounting Office's *Government Auditing Standards*. In accordance with those guidelines, we issued a report to the Tennessee Valley Authority's Inspector General.

Executive Council on Integrity and Efficiency Participation

As Vice Chair of the ECIE, the Board's Inspector General provides leadership, vision, direction, and initiatives for the ECIE on behalf of the Council Chair (Deputy Director for Management, Office of Management and Budget). The Inspector General also serves on the Comptroller General's Advisory Council on *Government Auditing Standards* (Yellow Book), a twenty-member group that works with the General Accounting Office to keep the auditing standards current through the issuance of revisions and guidance. Through our membership on the Advisory Council and other groups, we participate in, and set the direction for, a wide range of initiatives. During this reporting period, the ECIE worked with the PCIE to ensure that both councils were effectively positioned to implement the mission, vision, goals, objectives, and strategies established in the strategic framework adopted in May 2001.

Foster Interagency Approaches to Cross-Cutting Issues

As noted earlier, major economic, financial, and social trends (such as market globalization, technological and financial innovations, and statutory and regulatory framework revisions) will shape the environment in which the Board and the other financial regulatory agencies operate. These factors will also affect the strategic direction of the regulatory OIGs and require creative and innovative approaches to providing their respective agencies with assistance in managing change, maximizing the use of scarce resources, and ensuring continued compliance with applicable laws and regulations. Our work under this objective during this reporting period follows:

IG Community Participation

Through our membership and leadership role in the ECIE and our continued participation in the Council of Counsels to the Inspector General and the Interagency Ethics Council, we helped set the direction of interagency projects—including audits, inspections, and investigations. We also maintained communications with groups such as the Government Performance and Results Act Coordinators' Interest Group and the PCIE/ECIE Working Group on critical infrastructure assurance that helped us to share review techniques and offer OIG staff the opportunity to network with peers throughout the IG community.

Goal 3: Enhance the Efficiency and Effectiveness of Internal Operations

We plan to continually review our own processes, systems, and resources in an effort to improve our service delivery and to serve as an efficient and effective organization within the Board. Specifically, we plan to improve and streamline our major business processes, continue our investment in human capital, and focus on management approaches to produce the results envisioned in our strategic plan.

Continue to Improve Our Business Processes

Through the effective use of information technology and numerous process enhancements, we have made significant improvements in the way we perform our audits, investigations, and other projects. However, future technological innovations will provide additional opportunities for improvement. Our work under this objective for this reporting period follows:

Results of the Outside Peer Review of OIG Audit Operations

On March 14, 2002, the Government Printing Office (GPO) OIG issued a report of its peer review of our audit operations. *Government Auditing Standards* require such reviews to be performed at three-year intervals to ensure that audit departments are operating in accordance with the standards. The GPO OIG concluded that our system of quality control for the audit function in effect for the year ended September 30, 2001, was designed in accordance with the quality standards established by the PCIE and is being complied with to provide us with reasonable assurance of conforming with professional standards in the conduct of our audits. The overall report was accompanied by a management letter containing five recommendations for improvement in documenting several of our processes and our compliance with audit standards. We generally concur with the recommendations and plan to complete action on them during the next reporting period.

Enhance Our Human Capital Through Effective Leadership and Management of Our Staff

Human capital is the fundamental building block to achieving an organization's mission and goals, and we have integrated human capital considerations in developing our vision and values, goals and objectives, and the strategies to achieve them. Enhancing our human capital will be one of our highest priorities over the next several years. The major objectives are to

- provide opportunities for staff to do different and challenging work;

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- expand the staff's opportunities to learn and apply their knowledge and abilities;
 - expand staff's career choices, career paths, job enrichment options, and career opportunities;
 - allow staff to take responsibility for managing their developmental goals and career options;
 - produce experts of the Board's business and in the OIG's mission that will create best solutions for addressing issues and problems impacting the Board's programs and operations;
 - allow the OIG to assemble, integrate, and retain highly talented employees who stay at the forefront of their professions;
 - make it easier for OIG managers to coach, provide feedback, and develop the staff required to accomplish current and future business strategies; and
 - improve the quality of performance and career development discussions between managers and employees.

Individual Development Plan Program

During this reporting period, we continued work on our Individual Development Plan (IDP) program to better direct our investment in our staff's knowledge, skills, and abilities. We began a thorough analysis of our twenty-nine core competencies to develop specific performance expectations targeted at each of our staff's performance level (team member through project manager). We will complete this analysis during the second quarter of 2002, train the entire staff on the IDP process, then complete an initial development plan for each staff member.

Appendixes

Appendix 1

Audit Reports Issued with Questioned Costs for the Period October 1, 2001, through March 31, 2002

Reports	Number	Dollar Value	
		Questioned Costs	Unsupported
For which no management decision had been made by the commencement of the reporting period	0	\$0	\$0
That were issued during the reporting period	0	\$0	\$0
For which a management decision was made during the reporting period	0	\$0	\$0
(i) dollar value of disallowed costs	0	\$0	\$0
(ii) dollar value of costs not disallowed	0	\$0	\$0
For which no management decision had been made by the end of the reporting period	0	\$0	\$0
For which no management decision was made within six months of issuance	0	\$0	\$0

Appendix 2

Audit Reports Issued with Recommendations That Funds be Put to Better Use for the Period October 1, 2001, through March 31, 2002

Reports	Number	Dollar Value
For which no management decision had been made by the commencement of the reporting period	0	\$0
That were issued during the reporting period	0	\$0
For which a management decision was made during the reporting period	0	\$0
(i) dollar value of recommendations that were agreed to by management	0	\$0
(ii) dollar value of recommendations that were not agreed to by management	0	\$0
For which no management decision had been made by the end of the reporting period	0	\$0
For which no management decision was made within six months of issuance	0	\$0

Appendix 3

OIG Audit Reports With Outstanding Recommendations

Report No.	Audits Currently Being Tracked	Issue Date	Recommendations			Status of Recommendations ¹		
			No.	Mgmt. Agrees	Mgmt. Disagrees	Follow-up Completion Date	Closed	Open
Objective 1: Improve and Enhance the Board’s Program Operations								
A9508	Audit of the Board’s Consumer Compliance Examination Process	04/96	14	11	3	03/02	14	0
A9710	Audit of the Federal Reserve System’s Application Commitment Processing	01/98	5	5	0	06/99	4	1
A9810	Audit of the Board’s Supervisory Process for Implementing the Community Reinvestment Act	03/99	8	7	1	03/02	8	0
A0004	Audit of the Board’s Efforts to Implement Performance Management Principles Consistent with the Results Act	07/01	4	4	0	–	–	–
A0013	Audit of the Board’s Oversight Approach for the Federal Reserve’s Check Modernization Project	09/01	2	2	0	–	–	–
Objective 2: Strengthen and Streamline the Board’s Operational Infrastructure								
A9702	Business Process Review of the Board’s Travel Administration	07/97	9	9	0	01/99	1	8
Objective 3: Promote the Board’s Effective Use of Technology								
A9610	Audit of the Division of Banking Supervision and Regulation’s Distributed Processing	06/97	5	5	0	01/02	5	0
A0002	Review of the Board’s Implementation of Critical Infrastructure Protection	09/00	3	3	0	02/02	3	0
A0106	Audit of the Board’s Information Security Program	09/01	7	7	0	–	–	–
Objective 4: Help the Board Limit Risk and Ensure Compliance								
A9903	Review of the Board’s Frequent Flyer Policy	06/00	2	2	0	01/02	2	0
A0011	Audit of the Federal Reserve Board’s Government Travel Card Program	01/02	5	5	0	–	–	–
A0107	Audit of the Federal Reserve’s Background Investigation Process	10/01	3	3	0	–	–	–

¹ A recommendation is closed if (1) the corrective action has been taken; (2) the recommendation is no longer applicable, or (3) the appropriate oversight committee or administrator has determined, after reviewing the position of the OIG and division management, that no further action by the Board is warranted. A recommendation is open if (1) division management agrees with the recommendation and is in the process of taking corrective action or (2) division management disagrees with the recommendation and we have referred it to the appropriate oversight committee or administrator for a final decision.

Appendix 4

Cross-References to the Inspector General Act

Indexed below are the reporting requirements prescribed by the Inspector General Act of 1978, as amended, for the reporting period:

Section	Source	Page(s)
4(a)(2)	Reviews of legislation and regulations	16
5(a)(1)	Significant problems, abuses, and deficiencies	None
5(a)(2)	Recommendations with respect to significant problems	None
5(a)(3)	Significant recommendations described in previous Semiannual Reports on which corrective action has not been completed	None
5(a)(4)	Matters referred to prosecutory authorities	14
5(a)(5)	Summary of instances where information was refused	None
5(a)(6)	List of audit reports	3-14
5(a)(7)	Summary of significant reports	None
5(a)(8)	Statistical Table—Questioned Costs	25
5(a)(9)	Statistical Table—Recommendations that Funds Be Put to Better Use	26
5(a)(10)	Summary of audit reports issued before the commencement of the reporting period for which no management decision has been made	27
5(a)(11)	Significant revised management decisions made during the reporting period	None
5(a)(12)	Significant management decisions with which the Inspector General is in disagreement	None



Inspector General Hotline

1-202-452-6400

1-800-827-3340

Report: Fraud, Waste or Mismanagement

Information is confidential

Caller can remain anonymous

You may also write the:

Office of Inspector General

HOTLINE

Mail Stop 300

Board of Governors of the Federal Reserve System

Washington, DC 20551